

INITIAL STATEMENT OF REASONS FOR THE  
PROPOSED AMENDMENTS OF CALIFORNIA CODE OF REGULATIONS,  
TITLE 18, SECTIONS 24411 AND 25106.5-1

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR CIRCUMSTANCE THAT THE PROPOSED AMENDMENTS TO THE REGULATIONS ARE INTENDED TO ADDRESS

The proposed amendments to the regulations are intended to address potential confusion as to how dividends received from income that has been included in a unitary combined report and dividends received from income that has not been included in a unitary combined report should be treated for California franchise tax purposes. This confusion arises in part from two inconsistent decisions: one, the Court of Appeal decision in *Fujitsu IT Holdings, Inc. v. Franchise Tax Board* (2004) 120 Cal.App. 4<sup>th</sup> 459 (*Fujitsu*) (In part from a misreading of the Court of Appeal in *Fujitsu* on two examples in the regulations) and two, the State Board of Equalization (SBE) decision in the *Appeal of Apple Computer, Inc.*, Cal. St. Bd. of Equal., November 20, 2006, 2006-SBE-002 (*Apple*) and in part from a misreading of the Court of Appeal in *Fujitsu* or two examples in the regulations.

SPECIFIC PURPOSE OF THE PROPOSED AMENDMENTS TO THE REGULATIONS

The proposed amendments to the regulations are in response to the appellate court decision in *Fujitsu*. Staff is proposing amendments to Regulation sections 24411(e) and 25106.5-1(f)(2), not to change their substance, but to clarify an example in one of the regulations and, in the other regulation, to definitively set forth the rule for the ordering of dividends that are paid from income that has been included in a unitary combined report and from income that has not been included in a unitary combined report. The proposed amendments are consistent with the decision and analysis of the SBE in *Apple*.

NECESSITY

On November 20, 2006, the SBE published its decision in *Apple*. The year involved in *Apple* was 1989, and involved the same issues that were decided in the *Fujitsu* case and that are addressed by the proposed amendments to the regulations. After considering the arguments in *Fujitsu*, the SBE determined that the Franchise Tax Board's interpretation of Regulation sections 24411(e) and 25106.5-1(f)(2) was correct. The proposed amendments to the regulations are necessary in order to clarify the regulations to ensure that they will not be misconstrued in the future and to conform to the SBE decision in *Apple*.

## TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS

The Franchise Tax Board examined and considered notices, public hearing documents, written comments and responses thereto. The Franchise Tax Board did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing the adoption of this regulation.

## ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS

The Franchise Tax Board has determined that there were no alternatives considered which would be more effective in carrying out the purpose of the proposed amendments to the regulations or would be as effective and less burdensome to affected private persons or small businesses than the proposed amendments to the regulations. In addition, the proposed amendments to the regulations pertain to corporate taxpayers and therefore do not affect private individuals.

## ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has determined that the proposed amendments to Regulation sections 24411 and 25106.5-1 will not have a significant overall economic impact on business. The proposed amendments to the regulations are a clarification of the substance of the existing regulations.